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Federal Communications Commission
Office of the Secretary

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

ORIGINAL

In Re)
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Seller Financing of Broadcast)
Station Transfers)

MMB File No. 870921A

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To: The Commission

MOTION FOR DECLARATORY RULING

Crowell & Moring[1/] hereby asks the Commission, pursuant to Section 1.2 of the Commission's Rules, for a declaratory ruling to clarify Section 73.1150(a) of its Rules by defining the phrase "right of reversion in the license" as follows:

> "Right of reversion in the license" means the right, whether or not contingent, to reacquire the license without prior Commission approval.

I. SUMMARY

Seller financing facilitates the functioning of the marketplace for broadcast stations, easing entry by new broadcasters.[2/]

1/ Crowell & Moring is a Washington, D.C. law firm which represents, among others, broadcast stations and financial institutions providing financing for broadcast stations.

2/ In this regard, it is a vital element in achieving the first two of the six broad objectives recently reformulated and recommitted to by the Commissioners:

> 1. Promote, wherever possible, a competitive marketplace for the development and use of communications facilities and services; [and]

(Footnote continued)

It is often the only means by which potential broadcasters, particularly minority group members, can enter broadcasting. Seller financing which can be secured only by a security interest in the hard assets of the station often provides inadequate protection and is for that reason unattractive to sellers. Such financing would be more available were the seller permitted, upon default by the buyer, to take appropriate steps, including obtaining prior Commission consent, to again become the station licensee.

The Commission's Rules[3/] and past Commission decisions have, however, placed a cloud over such financing arrangements by creating the impression that they are impermissible "reversionary interests." That term appears to have been expanded well past its original (and justifiable) purpose of guarding against continuing

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[2/] (continued)

> 2. Provide a regulatory framework which permits markets for communications services to function effectively, while eliminating regulations which are unnecessary or minimal to the public interest[.]

FCC Release No. 3263, May 14, 1987.

[3/] Section 73.1150(a) provides: "In transferring a broadcast station, the licensee may retain no right of reversion in the license, no right to reassignment of the license in the future, and may not reserve the right to use the facilities of the station for any period whatsoever."

Section 73.1150(a) does not define what a "right of reversion" is and does not refer to seller financing. For these and other reasons discussed infra, we submit that what is needed is simply to clarify Section 73.1150(a). To the extent, however, that the Commission believes the language of this rule must be revised, it is requested that this pleading be considered as a petition for rulemaking.

control of stations by sellers. Commission policy as it has evolved, in substantial measure through unpublished staff actions, appears to prohibit seller-creditors from retaining a right to protect their loan by seeking Commission approval to reacquire the station they sold. This is a right that third-party lenders and option holders enjoy.[4/] It is difficult to understand, in law or logic, why a right to obtain a station license subject to FCC

4/ While we are aware of no clear case law on the subject, staff practice also prohibited, for a time, bank lenders and other third party financers of station acquisitions from becoming the licensee of a defaulting station even after prior Commission approval, requiring instead that the station be sold at public sale, at which the third party financer was permitted to bid.

The logic of this cumbersome procedure, whatever it may have been, seems to have faded away. As early as 1979, for example, Commission Staff approved the sale of radio stations WLW(AM) and WLWS(FM). The financing included pledge agreements which gave the lender the right, in the event of default and subject to prior FCC approval, to cause all of the defaulting licensee's stock (which was pledged to the lender) to be registered in its name and to exercise voting rights relating thereto. The pledge agreements made clear that the lender had no security interest in the licenses and no right to exercise control over the stations, direct or indirect, without prior Commission approval.

In approving the assignments, Commission staff advised that the lender's right to seek FCC approval of the licenses to it in the event of default were "inconsistent with [then] existing FCC policy," but that the lender could "at any future date, after default, submit an application for any FCC approval necessary to enforce those provisions, and that such application will be considered under then existing law and FCC policy." Letter to Roy J. Stewart, Chief, Renewal and Transfer Division, from Victor E. Ferrall, Jr., October 2, 1979, acknowledged by Stuart B. Bedell acting for Mr. Stewart.

approval is impermissible when the holder of that right is the previous licensee of the station, but not when the holder is not.

There is no apparent legal or policy reason why the prior licensee of a defaulting station should be barred from seeking Commission approval to again become the licensee. The burden such a policy imposes on the capital market for stations, however, is substantial. The rule clarification requested here will serve the public interest by facilitating seller financing, expanding the marketplace of funding sources available to station purchasers, and making entry into broadcasting more accessible, to the benefit of buyers, sellers and the public.[5/]

II. THE NEED FOR SELLER FINANCING

Rapidly escalating prices of broadcast stations have made financing an essential part of most station acquisitions. Large corporations or entities that have owned stations in the past may have sufficient resources to self-finance, or be able easily to obtain funding from third parties. Self-financing, however, is well beyond the reach of most smaller broadcasters, and especially, of many who seek to become broadcasters for the first time.

5/ The evolution of Commission policy on this matter has occurred principally through a handful of diverse and old cases involving disparate issues, and through informal (and unpublished) staff actions. For these reasons, the Commission may in fact have no present objection to the seller financing arrangements at issue here. If this is so, the requested clarification is especially important.

For almost a decade, encouraging minority ownership in broadcasting has been a critical Commission policy goal.[6/] Yet the substantial barriers faced by minorities in gaining a foothold in the industry continue.[7/] In seeking financing from banks and other financial institutions, minorities are hindered by the lack of prior station ownership or broadcast experience. Often they are charged high rates or denied financing altogether. Seller financing frequently offers the best, and even the only, way to raise the funds needed for minorities to purchase a station.

Sellers, denied the right to seek Commission approval to again become the licensee of the defaulting station, are often understandably reluctant to provide financing. Holding a security interest in the physical assets of a station is permissible, but inadequate, and leaves a seller with only the unattractive, and contrary to the public interest, option of seizing the collateral and taking the station off the air. A financing seller can go through the complex process of attempting to force the sale of a defaulting station through bankruptcy proceedings, but this provides no reasonable security and is certainly contrary to the public interest. Since a station license is not property which can be made subject to a pledge, lien, or other security interest,

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6/ Statement of Policy on Minority Ownership of Broadcasting Facilities, 68 F.2d 979 (1978).

7/ See, e.g., Advisory Committee on Alternative Financing for Minority Opportunities in Telecommunications, "Strategies for Advancing Minority Ownership Opportunities in Telecommunications" (May 1982).

see, e.g. Kirk Merkley, Receiver, 54 R.R.2d 68 (1983); Stephens Industries v. McClung, 789 F.2d 386 (6th Cir. 1986), reasonable security is often simply unavailable to sellers who would otherwise provide financing.

Permitting sellers to negotiate a contractual right to again become the licensee, after obtaining Commission approval, while not the perfect solution, would substantially improve the situation by facilitating seller financing. The Commission's Advisory Committee which proposed expanding financing opportunities for minorities (supra, note 7) correctly found that seller-financed transfers would be stimulated if sellers were afforded protection for their investments beyond the limited security interests currently permitted, and that expansion of seller-financing opportunities would stimulate minority ownership of broadcast stations to the public benefit.[8/]

III. THE PROBLEM: THE MURKY HISTORY OF THE PROHIBITION AGAINST "REVERSIONARY INTERESTS"

Through the years disparate actions by the Commission have created a cloud over seller-creditor security interests. There is substantial uncertainty as to precisely what financing arrangements are permissible and why. While the Commission staff, in considering proposed financing arrangements, appears to follow a

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8/ See Policy Statement and Notice of Proposed Rulemaking, Commission Policy Regarding the Advancement of Minority Ownership in Broadcasting, Gen. Docket No. 82-797, Dec. 13, 1982, at 1 and 14.

sort of "common law" in this area, it is difficult to find clear published precedent. Clarification is needed.

The cloud arises out of the non-statutory notion of "reversionary interests." A long history of less than clear decisions has obscured the original purpose of the prohibition. The "reversionary interest" prohibition was originally intended to deal with a specific evil which does not exist when a seller merely holds a contingent security interest.

Early in its history, the Commission confronted a practice where a station licensee would assign the license and lease the station's assets to a new operator for a period of time, generally five years or longer, at the end of which time the lease would end and the license would revert back to the seller. The "buyer" actually never had more than a limited role as temporary lessee of the station's assets and as temporary custodian of the license. In its seminal decision, The Associated Broadcasters, Inc., 6 F.C.C. 387 (1938), the Commission found such long-term lease arrangements violated Section 309 of the Act, which provides that a "station license shall not vest in the licensee any right . . . beyond the term thereof," because they gave the lessor a right to reacquire the license long after the current term of that license expired. The Commission also found that such arrangements violated Section 310's requirement for prior Commission approval before any assignment of a license.

The next year, in Alabama Polytechnic Institute, 7 F.C.C. 225 (1939), the Commission elaborated on its reasons for prohibiting lease-reversion agreements:

> By the device of such lease arrangements as this, persons or corporations holding broadcast station licenses are in a position to establish themselves indefinitely in control of a particular radio station, that is, they are able to put themselves in the same position at the expiration of the lease as though they had continued to operate the station during the lease period. . . .
>
> We do not consider it in the public interest to permit a practice to continue which has the effect of permitting existing broadcast licensees who disassociate themselves from the operation of their stations for a period of years to be in the same position as those who continue to operate their stations. . . . To permit this practice to continue would be to create a situation in which those persons now licensed to operate radio stations would be able to exercise a practical domination and control over the broadcast facilities in this country. . . .
>
> We do think that it is not in the public interest to permit a licensee to use the fact that he has a license, and is, therefore, in a unique bargaining position, as a basis for requiring a commitment to reassign the license to him from his assignee.

7 F.C.C. at 228-29.

Other commercial arrangements were devised which granted a seller the right to reserve substantial blocks of airtime on a station for its own programming, either combined with or apart from an automatic reversion after a period of time. The Commission repeatedly invalidated such time reservation agreements because they violated the principle of exclusive licensee responsibility for programming and improperly reserved control in the seller. See, e.g., The Yankee Network, Inc., 13 F.C.C. 1014 (1949).

In 1949, the frequency with which the Commission found it had to deal with such arrangements led it to adopt rules prohibiting practices which had the potential for continuing seller control over a station.[9/] The new rules were entitled "Special rules relating to contracts providing for reservation of time upon sale of a station." They were broadly written to prohibit station transfers in which the seller "retains any right of reversion of the license or any right to the reassignment of the license in the future, or reserves the right to use the facilities of the station for any period whatsoever." In its Report and Order, the Commission noted that its action merely "embodies in the form of a regulation the Commission's consistent interpretation of the provisions of the Communications Act in licensing and other proceedings." 43 F.C.C. at 406.[10/]

Subsequent cases did not elaborate on what was meant by these rules, other than to note that "reversionary interests," without

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9/ Promulgation of Sections 3.109, 3.241 and 3.641 Containing Special Rules Relating to Contracts Providing for Reservation of Time Upon Sale of a Station, 43 F.C.C. 405 (1949).

10/ These rules were later renumbered as Sections 73.139, 73.241 and 73.659. In 1979, they were combined into a single new provision, Section 73.1150, applying to all broadcast stations. Reregulation and Rules Oversight of Radio and TV Broadcasting, 44 Fed. Reg. 58719 (Oct. 11, 1979). The Commission changed the title of the rule to "Transferring a station," because "The old title is somewhat inappropriate since it referred only to reservation of time whereas the text refers also to rights of reversion and reassignment of license." Id. The Commission did not explain what these terms encompassed, except to note that "No substantive changes are made herein." Id.

defining them, were impermissible. The holding of the much cited Radio KDAN, 11 F.C.C.2d 934 (1968), for example, restated the Commission's position that contracts which subject a license to a mortgage or other security interest violated Section 301's prohibition on acquiring an "ownership interest" in a license. The offending mortgage also contained a clause entitling the mortgagee, who was the seller, to execute an assignment application should the buyer default. In dictum, a footnote declared the clause "void ab initio since it attempts to retain . . . a reversionary interest in the KDAN license." 11 F.C.C.2d at 934 n.1.

Although only a footnote unnecessary to the holding of the case, and despite the fact that the clause could well have been found objectionable if the mortgagee had been someone other than the seller, this broad language has been taken ever since to prohibit seller financing which grants the seller a right to reacquire the station upon default, even if prior Commission approval for the seller to do so is expressly required. Radio KDAN did not explain why such an acquisition by the seller would violate the Act. It presented a situation far different from the old lease/reverter cases. Nevertheless, the footnote has since often been cited, usually without explanation or analysis, whenever the specter of reversionary interest is raised.[11/]

11/ Not infrequently, citation of Radio KDAN will be coupled with citation of a more recent decision which contains no explanation or analysis except its own citation of Radio KDAN.

Since Radio KDAN, any agreement which authorizes a seller to seek prior Commission approval to again become the licensee of a station, even though expressly reserving no direct or indirect station control in the seller, and even though the agreement contains none of the evils the reversionary interest prohibition sought to prevent, has been assumed to be invalid.

The Commission last touched on this subject, albeit incompletely, in a 1985 rulemaking proceeding. Commission Policy Regarding the Advancement of Minority Ownership in Broadcasting, Gen. Docket No. 82-797, 57 R.R.2d 855 (1985). The specific proposal considered, at the initiative of the Commission's Advisory Committee on Alternative Financing for Minority Opportunities in Telecommunications, was to permit seller-creditors to have "the right to retain a reversionary interest in the license of the station being sold," when selling to minorities. The very act of labeling the proposal as a reversionary interest probably foreordained its rejection. Unfortunately, after reviewing comments, the Commission narrowly framed the issue as whether to permit what it termed "automatic reversionary interests." 57 R.R.2d at 858. It declined to do so.

The "automatic, reversionary interest" rejected by the Commission, however, was "an interest which passes solely by operation of law, and thus affords no opportunity for Commission review, upon the happening of some specified event such as default." 57 R.R.2d at 858 n. 15 (emphasis added).

A reasonable interpretation of what the Commission said is that interests which are not "automatic" are not illegal, but the Commission did not address this point. Instead, it left unclear whether contingent interests that vested only after Commission review and approval were permissible. It merely noted that no specific proposals were made in the comments "on alternative security interests short of an automatic reverter," and that "the record herein is insufficient to warrant authorization of any such alternative security arrangements." 57 R.R.2d at 858. The decision left Commission policy more uncertain than ever.

IV. SELLER FINANCING ARRANGEMENTS WHICH CONDITION LICENSE REASSIGNMENT, AFTER BUYER DEFAULT, ON FCC APPROVAL SHOULD BE PERMITTED.

The clarification requested here would eliminate the cloud of impermissiblity from the seller financing arrangement not considered in the Minority Ownership rulemaking; that is, retention by the seller of the right to again become the licensee of a station after prior Commission approval. The Act and the Commission's rules and policies should not be construed to prohibit such arrangements.

A. The evils identified in the cases which established the reversionary interest concept, and which Section 73.1150 prohibits, are absent. The seller, under such a financing arrangement, has no "right" to reacquire the station in the sense that transfer back to the seller is foreordained. The ability to reacquire the station is, in contrast to Associated Broadcasters and its

progeny, out of the seller's control. It arises only upon default by the buyer. The seller reserves no control, direct or indirect, over station programming or other operations, even after default occurs. The only right the seller has is to seek Commission approval, a right any third party option holder is permitted.

The cases often find a "right of reversion" to be improper because it grants the seller a "property right" in the license in violation of Section 309 of the Act. In the case of a right subject to prior Commission approval this is not correct, any more than it is true of an option to purchase a station. In fact, the seller does not even control the timing of exercising the right when it is contingent on default, whereas an option holder typically does control timing. The Commission does not treat options as "property rights" unlawful under Section 309 and, indeed, does not even consider them unless and until an assignment application is filed reflecting an intent, upon Commission approval, to exercise the option.

B. The other evil identified in the cases, automatic reassignment without Commission approval in violation of Section 310 of the Act, is also absent. The seller must secure prior Commission approval before regaining control of a station, consistent with Section 310. The Commission has full opportunity to make the required public interest determination, and has the benefit of public comment through the requirement of public notice, the 30-day waiting period, and the petition to deny process. If the Commission is free to accept or reject the application, and can

only grant it if it finds the assignment to be in the public interest, see Section 309 of the Act, there is no logical basis for a per se bar to such financing arrangements.

C. Permitting the seller to have such a contingent right simply grants the seller the same right that virtually all third-party creditors are offered. Commission staff now apparently does not prohibit financing provisions which entitle a bank or other third party lender to seek Commission approval to become the licensee.[12/] There is no reason why the legality of a financing arrangement should turn on whether the lender has been a Commission licensee.

While we have found no case law on the point, it may be that an unspoken justification for the staff policy was that the seller, having demonstrated its desire to give up station operation, could not be expected, upon again becoming the licensee, to have a bona fide commitment to operate the station for at least three years. Whether or not there was such a notion, the elimination of the Three Year Rule, Transfer of Broadcast Facilities, 52 R.R.2d 1081 (1982), has obviated any validity it may have had.

12/ See n.4 supra. Nor, for that matter, does the staff appear to object to financing provisions involving past owners other than the immediate past owner. If, for example, A sells a station to B and B then sells it to C, A can be an option holder with the right to acquire the station, or A can be C's creditor with the right to acquire the station upon C's default and Commission approval. B, however, cannot (it appears) be either. If anything, the entity most likely to be qualified to be a licensee is B, the immediate past licensee, its qualifications having been most recently passed upon by the Commission.

V. CONCLUSION

It is respectfully requested that the Commission adopt the clarification set out at the beginning of this Motion and, by so doing, facilitate seller financing of broadcast station sales to the benefit of effective functioning of the marketplace, new broadcasters, particularly minorities, and the public interest.

Respectfully submitted,

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